

**DOCKET SECTION**

**BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001**

**Postal Rate and Fee Changes, 1997**

**Docket No. R97-1**

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POSTAL RATE COMMISSION  
WASHINGTON, DC

**INITIAL BRIEF  
OF MAIL ADVERTISING SERVICE  
ASSOCIATION INTERNATIONAL**

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ASSOCIATION INTERNATIONAL**

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I. INTRODUCTION

Mail Advertising Service Association International ("MASA") is a trade association of more than 630 members representing a broad spectrum of businesses involved in the preparation of mail for customers using all classes of mail. MASA's membership is made up primarily of letter shops, mailing houses, list management firms, and other businesses that provide a range of services to customers using direct mail to communicate with members or potential customers. The typical MASA member is a small business that provides services to other small businesses in communities throughout the country. MASA's membership is expert in its knowledge of Postal Service rates and fees and in advising its customers in the most efficient and cost-effective way to communicate with their desired audience through use of the mail.

By MASA's own internal estimates, its members are responsible for almost 50% of the mail carried by the Postal Service annually in the Standard (A) class. MASA historically has participated in omnibus and other rate and classification proceedings initiated by the Postal Service before the Postal Rate Commission ("PRC" or "Commission"). MASA's overriding objective is to maintain efficient operations at the Postal Service so as to advance direct mail as a cost-effective method of communicating with American consumers and other audiences. MASA generally supports the Postal Service request for recommended rates in this rate case. MASA's principal concern is to preserve an appropriate rate structure and discount level within Standard (A) such that mailers will have the proper incentives to engage in work-sharing. This objective is an obvious benefit to mailers. It also benefits the Postal Service itself by shifting many of the tasks that would otherwise be performed by Postal Service personnel onto mailers who take advantage of the Service's discounted rate structure.

**II. THE COMMISSION SHOULD ACCEPT THE POSTAL SERVICE'S PROPOSED WORKSHARING DISCOUNTS BASED ON GREATER THAN 100% PASS-THROUGH OF COST SAVINGS.**

The Commission is presented in this case with a request for recommended decision which, with respect to certain of the Standard (A) discount categories, seeks a pass-through of greater than 100% of the attributable costs calculated by the Postal Service to be saved by worksharing performed by mailers. This request deviates from the Commission's usual rule that discounts will not exceed 100% of cost savings and, therefore, that discounted rates bear the same amount of institutional costs on a per-piece basis as the subclass as a whole. MASA supports this departure from the normal rule in the unique circumstances of this case.

In past cases, the Commission has used a variety of methods to calculate and determine the amount of cost savings generated by worksharing rate categories. As a result of the shift of certain components of Postal Service operations to mailers taking advantage of discounted rate categories, the Postal Service avoids certain costs that it would otherwise incur in processing mail. In the Opinion and Recommended Decision in MC 95-1, the Commission set forth three possible approaches for calculating cost differentials among worksharing categories within a subclass. PRC Op. MC 95-1 at IV-97-138 (discussing “clearly capturable cost avoidance,” “full cost difference,” and the “Appendix F approach”). In general, the Commission has concluded that “cost differentials should reflect costs avoided by required worksharing alone,” and should not take account of all cost differences between benchmark costs and the costs of a workshare category. Id. at IV-95.

In this case, the Postal Service proposes to pass through more than 100% of its calculation of costs avoided with respect to several worksharing categories. These categories include the basic automation, five-digit pre-sort, three-digit automation and five-digit automation letter categories in the Regular subclass, and automation letters in the ECR subclass. The Postal Service justifies these pass-throughs by reference to the new costing methodology, which substantially altered the Postal Service’s calculation of attributable costs for the affected subclasses and its calculation of avoided costs for the worksharing categories. USPS-T36-16. The Postal Service also justifies these pass-throughs for rate design reasons, noting that it sought to avoid major changes in discount levels and to limit percentage increases for individual rate categories. Id. at 17.

There are good grounds for adopting discounts at greater than 100% of avoided costs in this proceeding. As the Postal Service recognizes, its proposal is based on a major change in the manner by which attributable costs are determined and assigned to classes and subclasses. As one of the most significant examples, the new Postal Service methodology for calculating attributable mail processing costs has determined that such costs are only 80% attributable, in contrast to all prior rate proceedings, in which such costs have been assumed to be 100% attributable. The Postal Service's new costing methodology has come under considerable attack by certain intervenors in these proceedings. While MASA in general supports the Postal Service's efforts to develop more accurate methodologies for determining and assigning attributable costs, one thing is perfectly plain -- as with any new methodology, there are uncertainties associated with its application in the first instance. It may take several years to refine the new costing methodology and to enhance our understanding of its effects.<sup>1</sup> It is, consequently, problematic, and would be improper in this case, to treat the new costing methodology as if it were directly comparable (with respect to determination of cost avoidance) to the costing methodology used by the Commission in past cases.

As Postal Service witness Joseph Moeller's testimony demonstrates, applying a 100% limitation on avoided cost pass-throughs would result in dramatic dislocations between rate categories. Either the Commission would be forced to reject the discount tree, with the result that the discount differential between rate categories would be compressed or eliminated, or the

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<sup>1</sup> Indeed, if the Postal Service were to provide more current costing data, as some parties have suggested, it might well be the case that such data would lower the percentage pass-throughs to bring them closer to the Commission's stated optimum.

Commission would be forced to cut back the basic benchmark rates so that discounts at all rate categories would be no greater than 100% of avoided costs. Either solution would provide the wrong signals to mailers. Certain worksharing activities performed by mailers would be under-rewarded, by substantial margins. Mailers who mailed in worksharing categories that obtained a meager portion of the avoided costs in the form of a discount far less than 100% would be penalized. And, finally, the Postal Service would lose the benefit of many work-sharing functions that would otherwise be shifted to mailers in an appropriately structured discount scheme.

Accordingly, MASA supports the Postal Service request for discounts in certain instances in Standard (A) that are greater than 100% of avoided costs. The Commission has permitted deviation from the 100% pass-through standard before when justified by Postal management objectives or impact on mailers. As the Commission said in MC 95-1, “recommended discounts deviate from cost-avoidance-based rates . . . where the Commission concludes that management strategy or impact on mailers requires it.” PRC Op. MC 95-1 at IV-135. This is a unique case, in which the Postal Service proposes novel cost attribution methodologies for the first time. Unique circumstances demand flexibility, not slavish adherence to old principles. The Commission should leave to another day the application and possible reformulation of its principles guiding the determination of worksharing discounts, after the Postal Service and mailers have gained more experience with the new costing methodology.



**III. THE COMMISSION SHOULD MODIFY THE WORKSHARING DISCOUNTS PROPOSED BY THE POSTAL SERVICE FOR DROP SHIPMENT AND AUTOMATION CATEGORIES IN STANDARD (A).**

Although MASA generally supports the Postal Service request with respect to work-sharing discounts in Standard (A), MASA asks that the Commission modify the Postal Service's proposal with respect to drop ship discounts and automation discounts. The decrease in the discount differential between drop ship levels and the overall reduction in the automation discounts have sufficiently reduced the reward for worksharing to the point where mailers have significantly less incentive to participate in the Postal Service's worksharing programs.

**A. The Commission Should Increase the Destination Entry Discount Differential.**

The current differential between destination entry discount categories within Standard (A) is \$.005. The Postal Service proposal, which would establish a \$.003 differential between drop ship categories, provides an insufficient incentive for mailers to prepare and drop ship mail to the SCF. This disincentive is contrary to the interests of the Postal Service in that it will reduce worksharing activity and thereby saddle the Postal Service with additional work that could be more efficiently performed by mailers. It is likewise unfair to mailers, such as MASA's members, whose customers have come to expect that their mail will be drop shipped in accordance with the Postal Service's previous rate scheme. Even though drop shipping at the \$.003 increments proposed in this case may be uneconomical, a mailer may, nevertheless, be forced to drop ship mail because of his customers' expectations with respect to delivery schedules and reliability. Yet the mailer will not be able to recover all his costs of drop

shipping because he cannot pass on to his customer the shortfall between his own costs and the discount.

The Postal Service witness primarily responsible for the drop ship discount scheme, witness Moeller, clearly signaled that a greater differential than the Postal Service proposed was possible. Indeed, he acknowledged having considered other discount schemes and described how other possible discount levels would work. MASA/USPS-T36-4(c). In contrast, witness Moeller offered no rationale for preferring the \$.003 differential he proposes over the existing \$.005 differential.

AMMA witness Andrew offered direct testimony demonstrating that discounts can be established at \$.004. AMMA-T2. As witness Andrew testified, this is the minimum differential that the PRC should accept and the minimum that will provide a proper incentive for mailers to enter the destination entry discount program. The Commission should adopt witness Andrew's \$.004 differential.

The Commission should, however, reject Andrew's proposal to increase basic rates in order to expand the discount differential between drop ship levels. Substantial numbers of basic mailers would be penalized by Andrew's proposal in that their rates would increase by as much as three percent over and above the rates proposed by the Postal Service. It is unnecessary to increase base rates, however, for two reasons. First, Moeller suggested that it would be possible to increase the destination discount differential by \$.001 without increasing the basic rate in the Regular subclass. MASA/USPS-T36-4(c).<sup>2</sup> Second, because of the Postal

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<sup>2</sup> Moeller acknowledged that some increase in ECR base rates might be warranted. Id.

Service's apparently profitable test year and the over-estimation of its revenue requirement, the Commission has the flexibility to increase the differential in this case without increasing the basic rate. Witness Andrew estimated that the amount lost by increasing the discount differential without changing the basic rate under his proposal was approximately \$225 million. MASA/AMMA-T2-2.<sup>3</sup> Although estimates vary, it is plain that the Postal Service has overstated its revenue requirement by an amount well in excess of the amount of revenue deriving from Andrew's proposed increase in the basic rate.

Past decisions of the Rate Commission support adjusting the Postal Service's revenue requirement. E.g., PRC Op. R94-1 at II-7-9. Although certain intervenors and the Postal Service have objected that it is impossible to adjust the revenue requirement in this case without a full set of revised costing data, the Rate Commission has clearly, in past cases where it has adjusted the revenue requirement, been able to make modest adjustments in certain rates based on the amounts by which the revenue requirement has been reduced. MASA's current request that the Commission adopt a \$.004 drop ship differential and not make any further adjustment to the basic rate falls well within its authority and discretion as articulated in the Commission's prior cases.

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<sup>3</sup> Only \$71.58 million of this amount is attributable to the increase of the Regular subclass differential. The balance is attributable to the increase of the ECR differential. MASA/AMMA-T2-2.

B. The Commission Should Increase Automation Discounts to Protect the Investment of the Mailing Industry and the Postal Service's Automation Plans.

The Postal Service's aggressive move to an automated mail environment is no secret. As the Commission recognized in MC 95-1, the Postal Service began automating letter mail processing in the early 1980's, and by 1995 the automation of mail processing had evolved into the Service's "single most significant cost-reduction program." PRC Op. MC 95-1 at IV-4. A significant and critical part of the Postal Service's drive toward increasing automation is its worksharing discount program, which encouraged mailer investment in equipment necessary to prepare automation-compatible mail and take advantage of the automation discounts offered.

The Postal Service's proposal with respect to automation discounts has significantly reduced the amount of the discount at certain levels of the presort tree. For example, the discount from the basic presort rate to the basic automation rate for letters has decreased from \$.073 to \$.058, and the discount from 3-digit to 5-digit automation for letters has decreased from \$.02 to \$.018. Likewise, the discount for flats for basic automation to the 3/5-digit level has decreased from \$.088 to \$.036. The Postal Service justifies this decrease on the ground that due to the increasingly automated nature of the mail stream, the benefits from automating mail have decreased. In some cases, these discounts represent 80% of the value of the current discount level. Moeller, USPS-T36-18.

The contraction of the automation discounts is a function not only of the new costing methodology and the increasingly automated nature of the mail stream. It is also, to some extent, a result of the Commission's decision in MC 95-1 rejecting the Postal Service's request for an automation subclass. The Commission plainly recognized, in rejecting the proposed

automation subclass, that “rate differences are important determinants of whether mailers engage in [automation worksharing] activities.” PRC Op. MC 95-1 at V-161. The Commission must continue to recognize the detrimental impact of decreased discount incentives on the march to automation when it sets discounts in this proceeding.

The Commission should also recognize that reducing the automation discounts unfairly impacts those in the mailing community, many of whom are MASA members, who made substantial investments in equipment necessary to bar-code letters and otherwise make the mail prepared by these businesses automation-compatible. These mailers expected to recover their investment over time based on the discounts offered. Lowering the automation discounts substantially alters the economics of their investment decisions. Even though many of the discounts proposed by the Postal Service are for more than 100% of the Postal Service’s calculated cost avoidance, the Commission should maintain the current automation discount levels so that they equal 100% of their current value. This would not only fulfill the expectations of mailers who committed to the automation program, it would advance the Postal Service’s transition to an increasingly automated environment.

#### IV. THE COMMISSION SHOULD NOT INCREASE COST COVERAGES FOR STANDARD (A) MAIL BEYOND THE LEVELS PROPOSED BY THE POSTAL SERVICE.

Because of changes in costing methodology, resulting in lower cost attribution for significant elements of Postal Service costs, the relative cost coverages of First Class and Standard (A) mail have diverged under the Postal Service’s proposal. This divergence in cost coverage moves in the opposite direction from that taken by the Commission over several rate

cases. For a variety of reasons, the Commission has stated in the past that, as a matter of principle, it believes that cost coverages for Standard (A) and First Class mail should be moving closer together.

Whatever the merits of this course, which has proven controversial with respect to many intervenors in omnibus rate proceedings, it would be unfair to Standard (A) mailers to attempt further to implement that objective in this case. It is pellucidly clear that this case is unique because of the Postal Service's revolutionary new costing methodology. Under this new methodology, substantial costs that were previously attributable have been shifted into the institutional category, with the result that the overall system-wide level of attributable costs has been reduced. Likewise, there have been significant differences in the level of attributable costs for particular classes, subclasses, and rate categories within subclasses.

The Commission should not apply old cost coverage benchmarks without considering the uncertainties of the new costing data. Instead it should give itself and mailers time fully to understand the new methodology and its impact on different classes and subclasses of mail. Any significant deviation from the cost coverages proposed by the Postal Service here in order to bring Standard (A) more in line with First Class would result in a disproportionate increase in rates of Standard (A) mailers, not only compared to the system-wide increase but also on an absolute basis.

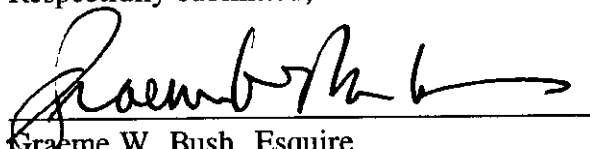
The Commission should likewise reject the efforts of some intervenors to reform completely the methodology for assigning institutional costs. As cross-examination, and rebuttal testimony from the Postal Service and other intervenors, has demonstrated, the

proposals of these witnesses, specifically those of witnesses Chown and Clifton, are deeply flawed and provide no basis upon which to assign institutional costs in this case.

### CONCLUSION

MASA supports the Postal Service's efforts to develop more accurate costing data and to establish generally moderate rate increases for most classes and subclasses of mail. For the reasons stated above, MASA asks that the Commission accept the rates proposed by the Postal Service for Standard (A) mail, with minor changes to preserve worksharing discounts and the legitimate expectations of automation mailers.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Graeme W. Bush', is written over a horizontal line.

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